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French Presidency of the Council of the European Union

Six months to advance the integration of banking and financial services markets

August 2008

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Introduction

With France now about to take over the presidency of the EU Council, we at the French Banking Federation (FBF) thought this would be a good time to review and express our opinions on the main issues that will determine the future of the banking and financial services sectors. Our objective is to help France make its presidency a successful one.

A constant commitment to European integration

French banks have always had an active interest and supported a unified market for banking and financial services in Europe. Indeed, all studies over the past few years show that integrated European markets will be good for both economic growth and employment.

If we look, for example, at retail financial services, integrated markets would have many benefits for:

- The banking industry – substantial economies of scale and scope, broader dispersion of risk, stimulation of innovation and enhanced competitiveness in a now global market
- Consumers – harmonised rules that provide a fair level of protection throughout Europe, easier comparison between competitor offerings, lower prices and an expanded range of products and services
- Europe's economy – a decisive contribution toward meeting the growth, competitiveness and employment objectives set by the Lisbon European Council, in March 2000.

Five key priorities for the French presidency of the EU Councill

Although well aware of the many constraints that go along with the job of presiding over the EU Council, we hope that during the six months of France's presidency substantial progress will be made toward integrating European banking and financial markets in the common interest of all Europeans. Indeed, some issues of major importance to the banking industry, such as supervision, are not progressing as fast as they should be, due to a lack of political will. During its presidency, France must give new impetus to European integration and propose compromise solutions that will enable its partners to overcome national conservatism. We feel there are five key areas where efforts should be focused:

1. Financial turmoil – ending the crisis and building a stronger financial system

We believe the number-one priority is to end the current financial crisis. This will require normalisation of the market for bank financing and also responsible and supervised use of more realistic accounting methods for valuing assets when markets fail and market prices do not reflect actual values.

We also recommend adopting structural measures that will provide a stronger foundation for this market, while being careful however not to compromise efforts to bring the current crisis to a swift end. These measures could include:

- Making all lenders subject to banking industry prudential supervision
- Re-examining the role and responsibilities of credit-rating agencies
- Developing cooperation between national supervisory authorities (see “Banking supervision” below)
- Making securitised instruments more transparent and improving the accounting methods used to value them, in particular by addressing the problems that inaccurate "fair value" valuations may pose.

Whatever measures are decided, French bankers would like to point out the very unfortunate consequences that a sharp increase in capital requirements could have until the crisis is over. They are however strongly in favour of harmonizing the common definition of "own funds" when revising the Capital Requirements Directive (CRD).

2. Banking supervision – moving at last from a national to a European approach

Fragmentation of banking supervision at the national level continues to be one of the main obstacles to the consolidation of Europe's banking industry. Moreover the current crisis has clearly revealed the need for a supervisory framework that can accommodate the size of pan-European groups.

To ensure effective supervision of such groups, we recommend that:

- They be supervised by colleges of supervisors whose decisions are overseen and approved by the "consolidating" supervisor, i.e. that of the parent company. The colleges of supervisors, whose main function would be to strengthen cooperation between the supervisors of group subsidiaries, large branches and the parent company, would be under the authority of the parent company's supervisor, which includes making important decisions when a consensus is lacking. At the very least the "comply or explain" rule would have to apply to supervisors who do not observe the college's decisions. CEBS could draft standards to govern the operation of these colleges.
- CEBS's role and powers be strengthened to increase cooperation among national supervisors and encourage them to harmonise their practices. This could involve, for example, amending the CEBS charter, increasing its resources, improving the decision-making process with qualified majority voting or giving it arbitration authority.
- National supervisors be required to cooperate with their European counterparts.

3. Financial markets – complete the work begun under the Financial Services Action Plan

The Financial Services Action Plan for 1999 to 2004 has accomplished much toward the integration of financial markets. More progress must be made however in two areas: 1) post-trade activities, by assessing the Clearing and Settlement Code of Conduct and completing the Target2-Securities project[1]; 2) asset management, by revising the UCITS directive and in particular providing management companies with a genuine European passport.

4. Retail banking – focus on demand must not hinder supply

We are disappointed by the Commission's initiatives for retail financial services in response to its review of the single market[2], since they are based primarily on demand considerations and propose no legislation in 2008. Although we feel these initiatives are important (especially those dealing with banking mobility and financial literacy) and moreover directly contribute to these efforts, they will have no direct impact on the integration of retail financial markets. We feel however this is certainly not the case with mortgage lending and strongly support the development of a pan-European market for home loans, as we have supported a single market for consumer credit. Lastly, we believe that significant progress in integrating retail markets for financial services will only be made if directives provide for targeted full harmonization[3].

5. Payments – to clarify the legal framework for interchange fees and move SEPA forward

The Single European Payments Area is a major project for Europe and French banks are investing considerable time and money to make it a success. However, after the MasterCard decision of 19 December 2007 it is essential that the European Commission clarify the framework for interchange fees, since the current legal uncertainty will seriously compromise the launching of SEPA direct debits and payment cards.

1. A single platform for the clearing and settlement of euro-denominated securities in central bank money.

2. See the Commission staff working document of 20 November 2007 entitled "Initiatives in the Area of Retail Financial Services" – SEC(2007)1520

3. Full targeted harmonisation consists in completely harmonising only those aspects that are most necessary to the cross-border marketing of products and services, such as interest rates, right of withdrawal, prepayment, precontractual information, etc.

The financial crisis

The main priority is to end the financial crisis. This will first of all require the normalisation of bank financing markets, and also the responsible and supervised use of more realistic accounting methods for valuing assets when markets fail and market prices do not reflect actual values.
Structural measures will also have to be adopted to provide a more solid foundation for the market. These measures may include:

- Making all lenders subject to banking industry prudential supervision
- Revising the role and responsibilities of credit-rating agencies
- Developing cooperation between European supervisory authorities (see "Banking and Financial Supervision" below).
- Making securitised instruments more transparent and improving the accounting methods used to value them.

In early 2008, we made concrete recommendations concerning the financial crisis in a report entitled "The International Financial Crisis – Analysis and Recommendations by the French Banking Federation".

The priority

The priority is to emerge from the crisis with maximum damage limitation. The market, after a severe shock, will correct itself in many cases. The risk for many products is more likely to be excessive behaviour (premature abandonment or stagnation of products and markets, which would otherwise be perfectly viable after any necessary changes to their regulations), rather than seeing the market kick into gear too quickly before its fundamentals have been sufficiently reorganised. As a result, short-term and medium-term actions need to be properly balanced. The most immediate problems that must be addressed are liquidity and the proper usage of accounting valuation rules.

With regards to liquidity, it is vital that central banks continue to provide the banking industry with the liquidity it needs, and in reasonable conditions with regards to:

- cost (any penalties must remain acceptable);
- duration (it is vital that access be made available to both 3-month and mediumterm funding);
- collateral (requests by authorities must correspond to the paper which is actually available);
- consistency (the various central banks must apply similar regulations);
- international flexibility (transfer from one currency to another).

With regards to valuations of instruments that are listed or traded on a market, the book value is normally the market value. However, the responsible and controlled use of models must become the norm when it is clear that there is a problem in the market which results in disclosures about the value of the instrument that are in reality misleading, and only reflect the lack of liquidity due to general mistrust.

Subsequent structural measures: the guidelines

A second priority is the development of tasks to accomplish in order to relaunch the market on solid foundations, without compromising its recovery period. These measures have to do with two main areas: market regulation and prudential supervision.

market regulation, involving three main issues:

- the ratings agencies;
- transparency with regards to products and their design;
- valuations and the adaptation of IFRS or US accounting regulations insofar as they impose the reference on the market in all circumstances.

The prudential question, involving three main issues:

- the subjecting of all institutions which are primary credit suppliers to the same type of supervision and regulation as banks;
- the supervision of banks' liquidity;
- the prudential incorporation of direct or indirect commitments made by banks, as well as the communication of this information (Basel pillars I, II and III).

Here again, any new and stricter practices need to be appropriately and gradually implemented, and at the right time, in order to avoid a sort of out-of-place and avoidable credit crunch. All these measures are currently being examined by the regulators.

All these issues have something in common, which can now be revealed. Regardless of the measures which need taking, **the solutions to the crisis, in regulatory terms, can only be dealt with at international level**: IOSCO for the markets, the Basel Committee for prudential issues, with global coordination by the Financial Stability Forum in anticipation of work carried out by the G7.

Action at European level may be justified on an individual basis, but only as an addition to the previous measures. However, there is one key area in which much more ambitious European action must be encouraged, and that is the **coordination of supervision**, especially in the banking sector. Note that the FBF makes recommendations on this subject.

Subsequent structural measures : the main concrete recommendations

The following comments and recommendations can now be made for a time period which goes beyond the immediate solving of the crisis to a healthy recovery by the market.

Loan delivery and guarantee

The principle for application across the board should be that any entities wishing to grant loans must be subject to **the same sort of regulations and supervision as banks**, and subject to all of the measures of Basel II. This measure concerns the United States in particular. Other way, the supervisors have to check that the guarantee provided by the credit enhancers will be sustainable.

Valuation

The valuation of securitised products at fair value based on market price, as a result of the application of IFRS and US GAAP, has revealed its limits. Even if it was not the source of the crisis, its use during liquidity crisis which affect the relevance of market prices must be ruled out. When their underlying assets are healthy, these products must be able to be reclassified in the held-to-maturity portfolio, and not just the held-for-trading portfolio, and carried by the bank at a value which is representative of the valued assets, taking into account impairment risk at maturity. If this reclassification option had been rapidly implemented it could have significantly contributed to ending the crisis. This must now be a medium to long-term goal.

Ratings agencies

This topic raises three issues: The first concerns the **subject of the rating process**. A clear distinction must be made between the rating of portfolios and vehicles and the rating of classic corporate debt or government debt, where changes in the rating depend on the issuer. The rating scales cannot be the same and methodologies must be adapted and communicated. Of course, regulated vehicles like credit institutions are comparable to corporate bonds.

The second point is that **a rating is and must remain an opinion** on the credit-worthiness of a specific debt issue and not on market liquidity or prices, unless a clearly distinct approach is used to evaluate the latter.

The third issue concerns the possible **conflicts of interest** of ratings agencies, either because they are paid by issuers, or because they act as consultants for the arranger and then rate the products. These conflicts need to be addressed by a code of conduct, as an extension of the existing code under the aegis of IOSCO. This code must include a rule that prevents firms from both advising and rating credit.

Pillar II and III Supervision

The Basel committee, in consultation with the profession, is responsible for establishing the adequate level of **information to be transmitted and the prudential integration** which will be required of institutions subject to the measures of Basel II, be it for pillar II or maybe pillar III, with regards to off-balance sheet commitments on all types of vehicles and instruments.

Banking and financial supervision

The current crisis has shown that banking supervision must now move from a national to a European approach.

To ensure effective supervision of pan-European banking groups, the FBF recommends:
- Having these groups supervised by colleges of supervisors whose decisions are overseen and approved by the "consolidating" supervisor, i.e. that of the parent company. At the very least the "comply or explain" rule would have to apply to supervisory authorities who do not observe supervisory college decisions.
- Strengthening CEBS's role and powers, for example by amending its charter, increasing its resources, improving the decision-making process with qualified majority voting or giving it arbitration authority.
- Mandating national supervisors to cooperate with their European counterparts.

Banking supervision

We are paying close attention to the work being conducted by the European Commission and the Ecofin Council on the Lamfalussy process, the Capital Requirements Directive (CRD), the ongoing financial crisis, financial stability and crisis management. The initiatives we feel are most important are the revision of the two main components of banking supervision in Europe: the CRD and the Lamfalussy process.

For quite some time, French banks have been defending a European-based as opposed to a national-based approach to banking supervision. The globalisation of financial activities means that the major banking groups are quite interdependent and therefore expose the financial system to substantial systemic risk at the European and even global levels. The current fragmentation of banking supervision at the national level cannot meet the challenges of this new situation and is one of the main obstacles to the integration of banking markets.

Moreover, the fact that the current financial crisis can only be settled at the European and global levels clearly illustrates this situation. Last March 13 and 14, at the Spring European Council, Europe's leaders themselves stated that "the current turmoil has revealed the need to strengthen the framework for maintaining financial stability, by reinforcing prudential supervision".

We believe that European banking supervision should be reorganized and recommend the following:

- Generalizing the use of colleges of supervisors to supervise cross-border banking groups when amending the Capital Requirements Directive (extension of article 129-2). These colleges of supervisors would facilitate cooperation, the exchange of information, the sharing of tasks and the delegation of authority between a group's various national supervisory authorities. Decisions taken by colleges of supervisors should be overseen and approved by the "consolidating" supervisory authority, i.e. that of the parent company. The colleges of supervisors would among other things provide supervisors in host countries with large banking subsidiaries with a more precise and therefore complete view of the risks associated with domestic banking activities than they currently have. Giving the parent firm supervisor the key role will align the supervision process with that of risk management in the leading global bank groups, which is centralized at the parent company. Supervisors that do not comply with supervisory college decisions would at the very least have to explain why, in accordance with the

"comply or explain" rule. The CEBS could draft standards to govern the operation of these colleges of supervisors.
- Reinforcing CEBS to enhance cooperation and the convergence of practice, for example, by amending its charter, increasing its resources, improving decision-taking with qualified majority voting or giving it mediation authority.
- Mandating national supervisors to cooperate with their European counterparts
- Reducing the number of national options provided for in the CRD
- Setting up a truly common reporting mechanism.

The current revision of the CRD should be used to make these improvements, and in particular set up the colleges of supervisors. This is our position in our response to the consultation on CRD revision the Commission launched on April 16.

The French presidency must consolidate the significant political progress made at the last Ecofin meeting on 14 May. However, it is particularly unfortunate that there is still no agreement on the expanded role to be attributed to the parent company supervisor, whose responsibility is still limited to simply co-ordinating the activities of the other supervisors.

Financial markets supervision

The Ecofin Council has approved the reports on the Lamfalussy process issued by the IIMG[4] and the Commission[5], the findings of which are positive overall, and has confirmed on 4 December 2007 that: " the application of the framework has generated additional momentum to, and increased the flexibility of the legislative process in allowing it to respond to technological change and market developments, by adopting implementing rules on a faster and more flexible basis. It has also paved the way for more effective supervisory co-operation and convergence". However, like the IIMG and the Commission, Ecofin considered that "further improvements in this areas should be introduced at all Lamfalussy levels".

In its November 2007 report the Commission notes that one of the main objectives of the Lamfalussy process is to stimulate cooperation and convergence in the area of supervision, but observes that despite the efforts " to put in place the tools necessary to achieve this objective, the results have not always met expectations". This observation applies not only to banking but to all financial services. Regarding the latter the main difficulties have to do with:

- CESR's decision-taking process, which is based on consensus
- The large discrepancies in the size and structures of the various financial markets and therefore in the concerns of CESR's national member supervisors
- CESR's lack of resources and in particular of funding
- CESR's incomplete charter. For example, there was no reference to cooperation or convergence when CESR was established.

These factors jeopardise the effective transposition of European directives into national law and their consistent implementation between the member states.

CESR must therefore have additional resources and authority. We propose the following changes:

- Give CESR the additional resources and authority it needs to arbitrate any differences of interpretation encountered when transposing EU directives into national law.
- Improve the decision-taking process with qualified majority voting.
- Apply the "comply or explain" rule to supervisors who do not follow CESR's recommendations.

4. Inter-institutional Monitoring Group (IIMG) report of 15 October 2007, entitled "Final Report Monitoring the Lamfalussy Process"

5. Commission paper of 20 November 2007 entitled "Reviewing the Lamfalussy process – Reinforcing Supervisory Convergence", COM(2007)727

Payments

- SEPA is a major project for Europe and French banks are making a considerable investment to ensure that it is a success.
- However, after the MasterCard decision of 19 December 2007 it is essential that the European Commission clarify the framework for interchange fees, since the current legal uncertainty is seriously compromising the launching of SEPA direct debits and cards.

The French are big users of non-cash payment instruments, making 240 such payments each year per person. Their transactions account for 20% of the 73 billion payments made in the European Union, even though France has only 12.4% of Europe's population. France has developed efficient payment systems that meet the needs of the general public. However, French banks are not resting on their laurels but continuing their efforts to improve quality and security and to develop new and innovative European payment instruments and products.

French banks are working to achieve Europe's SEPA targets

In 2002 French banks began to apply their successful experience in developing national payment systems to help Europe set up its Single Euro Payments Area, by playing an active role in the European Payments Council. Through the EPC European banks are working at the request of Europe's leading institutions to develop European payment instruments and systems capable of ensuring that all Europeans will be able to make payments in euros throughout Europe as efficiently and inexpensively as in their own country.

To co-ordinate and adapt the roll-out of European payment instruments in France, Banque de France and FBF co-chair the National SEPA Committee, on which all stakeholders are represented, including banks, government agencies, private-sector firms, merchants, consumers, Parliament, the Economic and Social Council, the French Mayors' Association and the press.

SEPA transfers lay the foundation for payments in Europe

On 28 January 2008, a major step toward a unified European payments system was made when the SEPA transfer became available throughout Europe. SEPA transfers will gradually come to replace bank transfers currently made within the EU member states. All banks have made the investments necessary to be ready for this major transition. New methods for identifying customer accounts have been implemented, interbank relationships have been expanded to European scale and new European-level infrastructures have been developed. SEPA transfers will therefore lay the foundation for Europe's new payment system.

But the success of SEPA transfers will depend on users, and above all on the speed with which businesses and government agencies use SEPA transfers for their day-to-day transactions with consumers and citizens.

Bankers want predefined guidelines for charging for interbank services

SEPA transfers will be followed by SEPA direct debit and card projects, which are even more ambitious and are currently underway throughout Europe.

Direct debit and card services, which have a more complex business model than transfers, require agreements or partnerships between the banks that operate these systems. This is why they are urgently asking European authorities to clearly explain what sort of operating guidelines they intend to adopt, so that they will be able to get on with designing and developing their projects. By deciding in late 2007 that an international card payments system could not charge interchange fees the European Commission has increased the legal and economic uncertainties at the core of Europe's card payment systems, which moreover have proven their capacity to satisfy customer requirements.

This decision sends a negative signal to market participants at a time when European authorities are insisting that they invest considerable sums to establish the Single European Payments Area. It also threatens the economic viability of existing payment systems and puts all new investment projects in this area on hold. This may have severe consequences for customers, since it may jeopardize the existence of the efficient and reliable systems they have come to appreciate.

Market participants have noted quite a discrepancy between the ambitious goals championed in the speeches and writings of European authorities and the contradictions and changes in direction that reflect the instability of their governance and management of SEPA projects.

Payments systems are capital-intensive infrastructure that are crucial to Europe's economic activity. Banks will be ready to invest in these systems when they are certain the outlook is clear from a market, regulatory and political perspective.

The need for harmonised payment regulations

The Payment Services Directive adopted in late 2007 is still a long way from achieving the harmonisation the banking industry recommended for Europe. Although full harmonisation was the initial objective, the directive has 23 provisions that are left to the discretion of the member states. Furthermore, 96 other provisions are ambiguous and lend themselves to divergent interpretations.

Consistent transposition and implementation of the directive in all member states will require careful coordination of the transposition process in each country. Since France will be presiding over the Council of the European Union in the second half of 2008, it is in a good position to provide a prime example of this coordination.

The banking industry will be carefully observing the activities of non-bank "payment institutions" and will make sure there is no drifting toward the management of deposit accounts since this could increase financial risk for the general public and undermine its confidence. Bankers will also make sure that competition is not distorted.

UCITS directive reform

- The FBF fully supports the revision of the EU framework for investment funds proposed by the European Commission.
- We are particularly supportive for the notification procedure (the mutual funds passport), the pooling of master and feeder funds, cross-border mergers between investment funds, the simplified prospectus and cooperation between regulators.
- The revision of the current framework would however be incomplete without an effective "passport" for asset management companies.

On 16 July 2008 the Commission proposed a revision of the EU framework for UCITS. The proposal does not include a section on the passport for investment management companies, as the Commission decided to ask the CESR to give an advice before 1 November 2008 on the supervision of investment management companies which use a passport.

The FBF fully supports the reform proposed by the Commission and in particular the amendments to the notification procedure (the mutual funds passport), the pooling of master and feeder funds, cross-border mergers between investment funds, the simplified prospectus and cooperation between regulators.

However, we feel that the directive's revision should be an opportunity to explain in greater detail and harmonise the roles and responsibilities of depositories, particularly with regard to mutual fund mergers, pooling and passports. We also believe that the reform must focus on the creation of UCITS and not on how they are marketed, since the sale of mutual funds is quite adequately governed by the Markets in Financial Instruments Directive (MiFID) of 21 April 2004.

Lastly, we would like to see the most extensive passport possible for management companies and hope that a section for a passport will be put back in the ongoing reform.

Setting up a single market for financial services will require passports to improve competition between market participants. There are already such passports for issuers of securities (the Prospectus Directive), for brokers and markets (the MiFID), for insurers (the Directive on Insurance Mediation), and for banks (the Banking Directive). Management companies are the only market participants who do not have a passport.

However, there are high costs to not having one. The impact study the Commission conducted in November 2006 for its White Paper indicated that by allowing management companies to operate from a single location within the European Union passports would reduce their investment, personnel, accounting and other expenditures and would save from 381 to 762 million euros a year. The average cost of setting up a local office is estimated at about one million euros.

These costs inevitably end up increasing the overall expense of setting up and marketing mutual funds, and are therefore at least partly borne by the end investor.

An effective passport for management companies is therefore an essential and indispensable step toward establishing a single European market for mutual funds and increasing competition that lowers costs for investors.

The FBF therefore hopes that the CESR regulators will agree on a supervision method for investment management companies using the passport and that the section on the passport will be adopted before the end of the current parliamentary term, similarly to the proposal published by the Commission on 17 July.

Post-trade activities

- A thorough assessment of the implementation of the Clearing and Settlement Code of Conduct adopted in November 2006 at the instigation of the European Commission is necessary.
- Although French banks fully support Target2-Securities they would like users to be more closely involved in this project.

The Clearing and Settlement Code of Conduct

Despite some progress, infrastructure commitments have failed to meet the expectations of securities issuers and market operators. Prices and services are far from being comparable, particularly considering the granting of discretionary discounts. The many requests (82) that infrastructure operators have made to have access to other infrastructure operators poses a threat to the economic viability of these systems and may increase the total cost for users, whereas Target2-Securities would avoid much of this problem. Furthermore, the success of these operators is far from assured.

The commitments to separate the accounting of different activities are insufficient, since they do not address the main concern of French banks that a distinction is necessary between the infrastructure activities of central securities depositories and competitive activities.

The Commission has committed to making a complete assessment of the code of conduct's implementation. The French presidency should provide an opportunity to show that the Council is determined to learn from and build on this assessment and verify that the infrastructures are complying with their commitments.

Target2-Securities

In July 2006, the Eurosystem launched the Target2-Securities project (T2S) with the objective of developing a single platform for the clearing and settlement of euro-denominated securities in central bank money.

As users of clearing and settlement infrastructures, French banks strongly support this platform, which among other things will contribute to the integration and efficiency of the single European market for securities trading. It will also reduce competitive distortions between infrastructures and banks in some markets and increase security by enabling clearing and settling in central bank money.

However, they would like to see users more closely involved in the project. They also note that the failure of some central securities depositories to participate in the T2S project may reduce the expected economic benefits and hinder the unification of post-trading activity in Europe.

Retail banking

- French banks have long supported the integration of retail banking markets.
- Targeted full harmonization will be necessary to achieve significant progress.
- European initiatives must above all seek to stimulate the cross-border supply of products and services, since it is mainly supply that will stimulate demand.
- French banks support the development of a pan-European market for mortgage credit, as they have supported a single market for consumer credit.

French banks have been promoting the integration of retail banking markets for quite some time. They are convinced that by increasing competition, lowering prices, stimulating innovation and enhancing competitiveness, integrated retail markets will bring benefits to the banking industry, companies, merchants, consumers and ultimately to Europe's economy in general.

Because they believe so strongly in this goal, French banks were somewhat disappointed by the initiatives the Commission decided after its review of the single market and which are presented in its working document of 20 November 2007. These initiatives do not sufficiently address the need to promote the supply of banking services. And yet it is primarily the availability of cross-border products and services that will stimulate demand in Europe, and therefore market integration, and not the current consumer demand for services. Since consumers naturally prefer to deal with local banks and other providers of financial services market participants must be encouraged to sell their products and services outside of their home markets. This is why we at the FBF feel that promoting the cross-border marketing of home loans, as presented in the December 2007 White Paper on Mortgage Credit, is a key priority.

The White Paper on Mortgage Credit

We strongly support the development of a pan-European market for mortgage credit. A single market for home loans would benefit consumers (by harmonizing consumer protection rules, facilitating comparison between loans and probably lowering prices) and lenders as well, by enabling economies of scale, dispersing risks and stimulating innovation.

However, in developing this market it is a very important that the use of surety bonds to secure loans on real property purchases[6], which is quite widespread in France, be taken into consideration. The popularity of surety bonds is largely attributable to the benefits that they offer consumers in terms of cost and flexibility.

To further promote competition, we also believe that the use of contractual provisions should not be restricted. It is important that banks be able to receive fair and objective compensation to offset their losses when loans are prepaid (especially fixed-rate loans) and to avoid systemic risks in markets with rapidly-rising interest rates.

Product tying

The Commission must also make a clear distinction between the concepts of "tying" and "bundling" or "package deal"[7]. This is because quite different regulations apply to each to account for the substantial differences in the sales context. For example, a tied sale may be necessary, as in the case of a payment instrument that naturally must be associated with a bank account. French banks actively cross-sell banking and insurance financial products to their customers, which enables French consumers to access and purchase these products more easily, while lowering marketing costs. Of course, selling multiple products this way means that consumers must be provided with abundant information and be given broad freedom of choice.

6. A surety bond is a guarantee commitment that is provided instead of real security, such as a mortgage. Surety bonds are considered by both banks and borrowers in France to be the most flexible and cost-effective form of security. Mortgage loans are often the norm elsewhere in Europe and particularly in the United Kingdom.

7. In France, it is illegal to sell bundled products or services unless they may be purchased individually or cannot be used separately.

Databases

Like the European Commission French banks believe that "data circulation between credit bureaus" must be smooth. This principle must not be used however to systematically challenge the validity of existing credit databases that have proven their effectiveness in promoting the use of credit, avoiding over-indebtedness, protecting personal data and ensuring non-discriminatory access.

We are not opposed to enabling access to existing national credit databases, provided that there is reciprocity, that national regulatory authorities approve and that equivalent restrictions and terms of access apply to all national operators. However, this is only feasible within a framework of full harmonization, such as provided for in the Consumer Credit Directive, for example.

Financial exclusion and literacy

We have read the Commission's report on financial exclusion issued in March of last year. Regardless of the criterion used it may be seen that France has one of Europe's lowest banking exclusion rates, with, for example, one of the highest ratios of bank accounts per capita (98%).

Regarding financial literacy, we agree with the Commission's findings concerning the importance of financial literacy and the need to improve this, presented in its Green Paper of March 2007. This is why we developed our "Les clés de la banque" (All about banking) information initiative, which includes a website and free brochures distributed in branch offices that provide consumers with advice and answers to their most frequent questions regarding money management, investment, payment instruments and more. Consumers may also pose questions directly to Les clés de la banque staff.
French banks regret however that the government is doing little to promote the financial literacy of consumers, and that educators often lack the economic and financial culture or tools required to teach young people the fundamentals of economics and finance. A few basic concepts are indeed essential to being able to manage a budget, use payment instruments, borrow or invest.
The French banking industry will be paying close attention to initiatives to promote financial literacy and is ready to implement Europe's best practices.

Banking mobility

The European Commission assumes that there is insufficient customer mobility between banks in Europe. This assumption is not justified and is even highly questionable. For one thing, it does not take into account that many customers have more than one bank.

This key characteristic of mature banking markets (which applies to a third of customers in France) ensures that consumers have broad freedom of choice and enables them to take advantage of competition between banks on a daily basis. Secondly, this assumption fails to account for consumer mobility within a given banking group, for example when customers change branches or change banks within a decentralized branch network.

French banks' commitments

Every year in France, several million individuals switch banks or open another account at another banks in order to take advantage of banking services which are better adapted to their needs or to changes in their professional or personal life, and to obtain more competitive offers.

To facilitate these switches and offer interested customers the appropriate assistance for switching accounts, the banking profession has decided to extend the existing measures in France. All banks will offer assistance in switching accounts which complies with the principles adopted by the Financial Sector Consultative Committee (CCSF) on May 26, and even goes beyond these provisions in certain cases. In particular, the banks will transfer, on customer’s behalf all credit transfers, direct debit and standing orders.

As part of this service, which will be fully rolled out by the end of 2009 at the latest:

- All banks will offer the service on request to any individual customers who have opened a current account in France.
- The new bank will explain how the service works to the customer in question and inform them of the different steps involved using relevant documentation, which will be available on the banks' websites in particular.
- The new bank will ask the customer in question for a formal agreement to act on his behalf. The customer will then provide the relevant information [1].
- The new bank will carry out the administrative formalities on behalf of the customer so that standing orders, direct debit and credit transfers appear in the new account. Once it has received the necessary information, the bank will inform all creditors and debtors of the request to switch banks within five working days[2].
- The new bank will also put in place any permanent transfers that the customer wishes to issue from his new account within five working days.
- If the customer so desires, he may close his former account. The former banks will close the account within 10 working days. If cheques for the old account are submitted, the bank will make every effort to warn its former customer and enable him to settle the situation before the cheque is rejected.

This new service is already available in some banking networks, and will improve the existing assistance available for customers who want to switch banks:

- A free guide to switching accounts, available either in branches or on the Internet, providing clear and comprehensive information on how to switch banks.
- No charges for account closures for any deposit or saving accounts.
- A service offering a summary of all automatic and recurring operations, meaning that none are overlooked during the transfer.

As for cross-border mobility, SEPA and the Payment Services Directive (PSD) should make a substantial contribution to promoting this throughout the euro zone. The Commission should therefore wait until the full impact of SEPA and the PSD can be appreciated before considering further initiatives in this area.

Banking mobility can now be facilitated through competition and self-regulation. This is why French bankers are actively contributing to the European Banking Industry Committee's efforts to satisfy the Commission's request to develop, by mid-2008, a common body of rules that would enable all consumers throughout the European Union to change banks more easily.

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1. Information on credit transfer, direct debits and standing orders – in both directions – for transfer (bank statements, invoices, repayment schedules, details of permanent transfers and/or the addresses of issuers, etc.)

2. The time necessary for the issuers of credit transfer, direct debit and standing orders tto enter the new bank details does not depend on the bank but on the aforementioned issuers.

Transatlantic dialogue on financial market regulation

- The FBF recommends mutual recognition of regulations rather than exemptions.
- In order to avoid competitive distortions within Europe that would conflict with the single market's fundamental purpose, mutual recognition must be multilateral (i.e. between the SEC and the European Commission/CESR) and not bilateral (between the SEC and each national regulator).
- Mutual recognition must be based on the principle of equivalence, to prevent US investment banks from doing business in Europe without being subject to European constraints.

In early February 2008, negotiations between the Securities and Exchange Commission (SEC) and the European Commission resulted in a joint statement announcing a project to establish mutual recognition between financial market regulators and regulations. The objective is to give investors direct access to a broad range of financial products on both sides of the Atlantic and reduce the transaction costs that arise from regulatory differences, in exchange for enhanced information and security.

The mutual recognition principle may be applied to all investment banking products and services intended for institutional investors, whether brokerage services (by enabling access to markets) corporate debt or equity financing or securities trading (via remote screens, etc.).

Three different approaches are possible:

- Regulatory **convergence** (a medium to long-term goal)

- **Mutual recognition** between securities regulators, which can be set up more rapidly. Mutual recognition may either be multilateral (between the SEC on the one hand and the European Commission/CESR on the other) or bilateral (between the SEC and each market regulator).

- **Exemptions**, which may be rapidly implemented and involve waiving regulations that pose an unjustifiable obstacle to wholesale transatlantic transactions.

Whatever approach is adopted over the near term (whether mutual recognition or exemptions), European investment banks will be able to access US markets as if they had a "transatlantic passport", and propose their services to US institutional investors, while US investment banks will be able to sell their services in Europe. Each would be subject to their home regulations.

We prefer the mutual recognition approach to exemptions. Like the European Commission, we believe that mutual recognition must be multilateral as opposed to bilateral, to avoid creating competitive distortions within Europe. This means that the SEC will first negotiate with the Commission and CESR and that the new rules will have to be clearly established at the European level before moving on to the practical phase of actually recognizing each local regulator (FSA, AMF, BaFin, Consob, etc.). This process to achieve mutual recognition among regulators will require closer cooperation between them and lead to a sort of "co-supervision" of financial markets, which the recent crisis has shown to be already largely transatlantic.

Mutual recognition must be based on the principle of equivalence, in other words, US investment banks doing business in Europe must be subject to the constraints of the European environment when their corresponding US regulations are not less severe. The European Commission must therefore define the essential core of European rules that US investment banks must observe when requirements under US laws and regulations are not equivalent.

VAT on financial services

- The FBF supports the Commission's initiative to revise the VAT regime that applies to financial services.
- We are particularly favourable to redefining the list of VAT-exempt services and support an arrangement that would enable firms to choose to have their bank and financial transactions subject to VAT.
- However, we recommend that a full-fledged VAT group regime be established, since this would certainly be more effective than the Commission's proposal to make cost-sharing arrangements VAT-exempt.

VAT legislation adopted in 1977 exempts financial and insurance services from value-added tax. Some EU member states give credit institutions the option of charging VAT on the services they provide. When this option is not available or has not been exercised, insurance companies and financial institutions cannot recover the VAT they pay on the goods and services they purchase, which results in a "hidden VAT" expense that increases the cost of the services they provide to other firms.

To ensure that VAT is not an obstacle to the development of an integrated, open, efficient and competitive single market for financial services, on 28 November 2007 the Commission adopted a proposal for a directive and another for a regulation, intended to modernize and simplify the complex VAT rules that apply to financial and insurance services.

The Commission's proposal includes these three measures:

- **Redefining the list of VAT-exempt services**, so that exemptions will take the financial services sector's current complexity and diversity more fully into account.
- **Granting** insurance companies and banks **the option of making their services subject to VAT**. Although this option is already available in the current VAT directive, it is left to the discretion of the member states, which rarely opt for this.
- **Introducing VAT exemption on cost-sharing arrangements, including across borders**. This measure will enable companies to pool their transactions in VAT groups and share costs among group members without creating an irrecoverable VAT expense.

Redefining the list of VAT-exempt services

We approve the Commission's work to redefine VAT-exempt services. In our response to the Commission's public consultation of May 2006 we had even pointed out that updating definitions was an absolute priority. To ensure transparency, we also asked that the VAT Committee's proceedings be made public, since its role is to define common guidelines and practices that will ensure consistent application of VAT rules within the EU.

We believe however that the Commission's approach is rather difficult to understand. To the directive's list of financial services categories have been added services that have specific and essential characteristics of exempt services, services they do not have such characteristics and items that cannot be considered to fall within the scope of the definition; with the last two categories not being exempt.

Europe's banking industry has also observed that the proposal's definitions of payment transactions and derivatives transactions could be improved.

Making VAT exemption on financial services optional

The EU member states are currently free to choose whether they will allow their taxpayers the option of making their banking and financial transactions subject to VAT. If they grant this option they can determine the terms of its exercise and may limit its scope.

As of 1 January 2012, this option will be directly granted to financial institutions. It will not be subject to any sort of condition or restriction, and will apparently be applicable on a transaction-by-transaction basis, which would enable VAT charging on B2B transactions.

We are very pleased to see that business-to-business services will be taxable, since allowing companies subject to VAT to charge VAT to other companies that are allowed to recover VAT on their purchases will promote fairer pricing and greater efficiency.

VAT exemption on cost-sharing arrangements

The EU member states will be able to exempt from VAT the services that a tax-paying group provides to group members when certain conditions are met.

We believe that the conditions the Commission proposes are too strict. We also feel that a genuine VAT group regime would be preferable to the proposed system.

A VAT group regime would enable more efficient outsourcing of specific banking activities through the creation of subsidiaries. Fifteen EU member states (including the UK, Germany and Italy but excluding France) have decided to set up such a regime in their country.

The FBF

The French Banking Federation (FBF) is the professional body that represents all banks operating in France. This includes almost 500 French and foreign, commercial, co-operative and mutual banks.

The key role of banks in France's economy and society

The combined assets of FBF member banks totalled 2.6 times French gross domestic product in 2006. The banking industry directly employs 1.6% of the working population, or over 400,000 people, making it France's third-largest private sector employer. Banking also accounts for some 200,000 indirect jobs. With almost 1,500 billion euros in loans outstanding at end-June 2007 (over 80% of French GDP), the banking industry also plays an essential role in financing economic activity and therefore in growth and employment.

Increasingly global

French banks are present in 84 countries worldwide with almost 1,000 offices. This is 92% more than just five years ago. In 2007, foreign operations accounted for over a third of the revenue of the three largest French banks. Most of this global expansion has of course been in Europe, where French banks had 523 offices at end-2006, or almost twice as many as in 2001. It should also be noted that there are many foreign banks in France, and that Europe accounted for 159 out of 237 (67%) of the foreign bank offices in France in 2007. Foreign banks account for 11% of total bank assets.

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